

LEAD

BEFORE THE ARIZONA CORPORATION COMMISSION

Arizona Corporation Commission

COMMISSIONERS

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JEFF HATCH-MILLER, Chairman
WILLIAM A. MUNDELL
MARC SPITZER
MIKE GLEASON
KRISTIN K. MAYES

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AZ Corporation Commission
Director Of Utilities

IN THE MATTER OF THE APPLICATION OF
LEVEL 3 COMMUNICATIONS, LLC FOR
APPROVAL OF INCURRING DEBT AND
FINANCING OBLIGATIONS.

DOCKET NO. T-03654A-04-0910

DECISION NO. 67810

ORDER

Open Meeting
May 3 and 4, 2005
Phoenix, Arizona

BY THE COMMISSION:

On December 17, 2004, Level 3 Communications, LLC ("Level 3" or "Applicant") filed an application with the Arizona Corporation Commission ("Commission") requesting approval pursuant to A.R.S. § 40-285 to grant a security interest in its Arizona assets as part of financing arrangements involving its corporate parent, Level 3 Financing, Inc. ("Level 3 Financing").

On March 22, 2005, the Commission's Utilities Division Staff ("Staff") filed a Staff Report recommending approval of the application.

* * * * *

Having considered the entire record herein and being fully advised in the premises, the Commission finds, concludes, and orders that:

FINDINGS OF FACT

1. Level 3 is a Delaware corporation and a wholly owned subsidiary of Level 3 Financing, which is in turn a wholly-owned subsidiary of Level 3 Communications, Inc. ("Parent Company"). Level 3 is an authorized provider of intrastate telecommunications services in the State of Arizona and is authorized to provide telecommunications services nationwide.

2. In Decision No. 61737 (June 4, 1999), the Commission granted Level 3 a Certificate of Convenience and Necessity with authority to provide competitive resold and facilities-based local

1 exchange, exchange access, and interexchange telecommunications services in Arizona.

2 3. By its application in this proceeding, Applicant seeks approval to grant a security
3 interest in its Arizona assets in connection with a refinancing. The Staff Report states that as of
4 December 31, 2003, the book value of Level 3's assets in Arizona was \$122,438,153.

5 4. Level 3 provides service to 4 governmental entities and 329 business/wholesale
6 customers in Arizona.

7 5. The application states that Applicant's parent, Level 3 Financing, has entered into a
8 credit agreement whereby Applicant, upon obtaining regulatory approval, will pledge its assets and
9 act as guarantor with respect to the credit agreement in the aggregate principal amount of up to \$850
10 million.¹

11 6. Level 3 states in its application that the proposed transactions will be transparent to
12 consumers, will not cause a change in its officers or directors, and will not alter the rates, terms and
13 conditions under which it currently provides service in Arizona.

14 7. The Staff Report describes the refinancing for which Level 3 requests authority to
15 encumber its assets as follows: On December 2, 2004, Level 3 Financing completed purchase of
16 \$1.105 billion principal of outstanding debt due in 2008. The purchase reduced amounts due in 2008
17 to approximately \$1.3 billion, a 46 percent reduction in required debt service. Funding for the
18 purchase was provided by new debt issues of \$1,075,000,000 that pushed the maturities of the
19 amount purchased and reissued to 2011. The transaction further reduced annual cash interest expense
20 by \$28 million, enhancing Level 3 Financing's ability to repay existing debt. As part of the credit
21 package, Level 3 Financing offered for sale \$345 million of 5.25 percent convertible notes due in
22 2011. Most of the proceeds of the note sales, along with \$730 million of funding from a senior
23 secured loan, were used to complete the refinance. A portion of the proceeds of the sale of the notes
24 was used to enter into bond hedge and warrant transactions related to Level 3 Financing's common
25 stock. The \$345 million convertible debt can be exchanged at any time, subject to certain
26 adjustments, for 251.004 shares of common stock per \$1,000 debt face value as long as the
27

28 ¹ The initial proceeds received under the credit agreement will be approximately \$730 million, but the credit agreement allows for additional funds to be paid of up to \$850 million.

1 conversion takes place before December 15, 2011. The conversion rate equals to \$3.984 per share.

2 8. In its analysis of the application, Staff examined the consolidated financial statements
3 of the Parent Company and its affiliates for September 30, 2004 taken from the Parent Company's
4 Form 8-K. The consolidated entities had operating losses of \$381 million for the 9 month period
5 ended September 30, 2004, which represents an improvement over the \$590 million loss in the
6 similar period the previous year. Staff determined that the refinancing package did not alter the
7 consolidated entities' capital structure,² and that the amount of debt outstanding also remains
8 approximately the same.

9 9. Staff states that the consolidated entities' financial performance and capital structure
10 would normally preclude authorization of the requested pledge of assets, but that since Level 3 has
11 only governmental and business customers and there are many other sources for the services provided
12 by Level 3, Level 3's customers would not be materially harmed by possible default on the loan
13 facilities or the demise of Level 3's parent companies.

14 10. Staff states that authorization of the pledge of assets and guarantee in support of the
15 financing transactions is warranted because the refinancing extends maturities on debt obligations,
16 resulting in enhanced ability to repay existing debt. Staff states that the pledge of assets and
17 guarantee will not impair Level 3's ability to provide telecommunications services in Arizona.

18 11. Staff recommends approval of Level 3's request for authorization to pledge its assets
19 in support of loans in the amount of \$1,075,000,000 obtained by Level 3 Financing on the terms and
20 conditions described in the application, and recommends approval of Level 3 granting liens in favor
21 of the lender as required to secure the borrowings. Staff further recommends authorizing Level 3 to
22 engage in any transaction and to execute any documents necessary to effectuate the authorization
23 granted.

24 CONCLUSIONS OF LAW

25 1. Level 3 is a public service corporation within the meaning of Article XV of the
26 Arizona Constitution and A.R.S. § 40-285.

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28 ² Staff notes that because the \$345 million debt package is convertible to common stock, the consolidated capital structure of the Parent Company and its affiliates could improve upon conversion.

2. The Commission has jurisdiction over Level 3 and the subject matter of the application.

3. Authorization of Level 3's pledge of assets and guarantee in support of Level 3 Financing's credit agreement is compatible with the public interest.

4. Staff's recommendations in Findings of Fact No. 11 are reasonable and should be adopted.

ORDER

IT IS THEREFORE ORDERED that, pursuant to A.R.S. § 40-285, Level 3 Communications, LLC's application for approval to grant a security interest in its assets as set forth in its December 17, 2004 application is hereby granted.

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1 IT IS FURTHER ORDERED that Level 3 Communications, LLC is hereby authorized to
2 engage in any transaction and to execute any documents necessary to effectuate the authorization
3 granted.

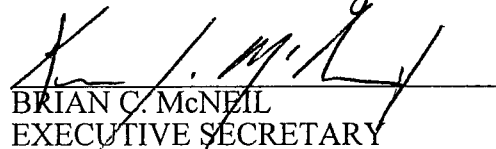
4 IT IS FURTHER ORDERED that this Decision shall become effective immediately.

5 BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

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8 CHAIRMAN COMMISSIONER COMMISSIONER

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12 COMMISSIONER COMMISSIONER

13 IN WITNESS WHEREOF, I, BRIAN C. McNEIL, Executive
14 Secretary of the Arizona Corporation Commission, have
15 hereunto set my hand and caused the official seal of the
16 Commission to be affixed at the Capitol, in the City of Phoenix,
17 this 5th day of May, 2005.

18 
19 BRIAN C. McNEIL
20 EXECUTIVE SECRETARY

21
22 DISSENT _____

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24 DISSENT _____

25
26 TW:mj

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